Financial Conduct Authority

# FINAL NOTICE

**To:** **Peter Francis Johnson**

**IRN:** **PXJ00074**

**Date:** **19 May 2016**

## 1. ACTION

1.1. For the reasons given in this notice, the Authority hereby:

(1) publishes a statement of Mr Johnson's misconduct (a "public censure"), pursuant to section 66 of the Act for failing to comply with Statements of Principle 1 and 4. Mr Johnson provided verifiable evidence of serious financial hardship. Had it not been for his reduced financial circumstances the Authority would have imposed a financial penalty of £200,000; and

(2) makes an order, pursuant to section 56 of the Act, prohibiting Mr Johnson from performing any function in relation to any regulated activity carried on by an authorised person, exempt person or exempt professional firm. This order will take effect from 19 May 2016.

1.2. The public censure takes the form of this Final Notice which will be published on 19 May 2016 on the Authority's website.

1.3. By a Decision Notice dated 7 November 2014, the Authority notified Mr Johnson that it had decided to impose a financial penalty of £200,000 and to make an order prohibiting him from performing any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm.

1.4. Mr Johnson referred the matter to the Upper Tribunal (Tax and Chancery Chamber) ("the Tribunal") on 4 December 2014. On 17 May 2016, Mr Johnson withdrew his reference and the Tribunal gave its consent to this withdrawal. With Mr Johnson's consent, a Further Decision Notice was given to him, pursuant to section 388(3) of the Act, in respect of the same matter as the Decision Notice dated 7 November 2014.

1.5. Following Mr Johnson's withdrawal of his reference to the Tribunal and his waiver of his right to refer the Further Decision Notice to the Tribunal, the Authority has issued this Final Notice.

## 2. SUMMARY OF REASONS

2.1. Keydata designed, launched and, via IFAs, distributed structured investment products to retail customers. Keydata went into administration on 8 June 2009 and was dissolved on 2 July 2014. Prior to its administration, Keydata had £2.8 billion of its own and other institutions' investment products under administration. During the Relevant Period (26 July 2005 to 8 June 2009) Keydata designed, launched and distributed four investment products which invested primarily in US senior life settlement policies: the SIB, the SIP, the Income Plan and the DIP.

2.2. The Products offered retail customers an income or growth investment, by way of ISA, personal equity plan or direct investment. The income option paid a fixed percentage income (payable quarterly or annually) and aimed to ensure the full return of capital to the investor at the end of a five, seven or ten year term. The growth option rolled up and accrued the income payments to provide a compound growth over the life of the Product and aimed to ensure the full return of capital to the retail investor at the end of a five, seven or ten year term. Keydata purchased, on behalf of the investors, bonds issued by a special purpose vehicle incorporated in Luxembourg (either SLS or Lifemark). The SLS Products were underpinned by investments in the SLS Bonds. The Lifemark Products were underpinned by investments in the Lifemark Bonds. The SLS Bonds and the Lifemark Bonds were to be listed on the Luxembourg Stock Exchange.

2.3. The funds raised through the issue of the SLS Bonds would then be invested by

SLS in the SLS Portfolio, and similarly the funds raised through the issue of the Lifemark Bonds would then be invested by Lifemark in the Lifemark Portfolio. The structures of the SLS and Lifemark Portfolios were broadly similar: they contained US senior life settlement policies and required an amount of the funds raised to be kept in cash (or liquid securities) to fund the payment of fees, income and insurance premiums. The target spread for the SLS Portfolio was 40% cash and 60% policies and for the Lifemark Portfolio was 30% cash and 70% policies.

2.4. Mr Johnson held Controlled Functions 10 (Compliance oversight) and 11 (Money Laundering Reporting) from the start of the Relevant Period until 1 December 2008 and held Controlled Function 30 (Customer) throughout the Relevant Period. As Keydata's Compliance Officer, Mr Johnson was responsible for carrying out the due diligence, overseeing the verification and approval of the financial promotions in respect of the Products (in particular the SIB 1 and 2 and the SIP 1) and Keydata's compliance with regulatory standards. In relation to the due diligence of the SIB 4 and the SIP 1, Mr Johnson was heavily involved in the collation and assessment of the due diligence data and reported his findings to the Keydata board of directors. After 1 December 2008 Mr Johnson was Keydata's Operations Director but was not appointed to the Keydata board of directors. In this role Mr Johnson retained responsibility for Keydata's dealings with the Authority in relation to the Products, and the Authority considers that, as Operations Director, he continued to have some responsibility for Keydata's compliance with regulatory requirements in relation to the Products.

2.5. During the Relevant Period, Mr Johnson:

(1) failed to act with integrity in carrying out his controlled functions , in breach of Statement of Principle 1, in that he:

(a) was aware that:

(i) Keydata had received professional advice that its financial promotions contained unclear, incorrect and misleading statements and had failed to take the steps recommended by its advisers to address those matters;

(ii) Keydata had received professional advice that its due diligence was inadequate and had failed to take the steps recommended by its advisers to address the failings; and

(iii) Keydata had received professional advice regarding the risk of the Lifemark Portfolio not performing, and that Keydata had failed to take adequate steps to ensure that the risk was being effectively managed and that investors and IFAs were aware of this risk;

and, despite being increasingly aware of the significance of these matters and of the non-performance of the SLS Products, recklessly failed either to take adequate steps to ensure that Keydata addressed the issues and risks that had been identified in relation to the Lifemark Products or to take adequate steps to stop Keydata from marketing and selling the Lifemark Products until effective remedial steps were taken;

(b) recklessly failed to take adequate steps to ensure that Keydata explained or mitigated the risk to investors who had invested in the Lifemark Products, and that material circulated to such investors gave an accurate impression of the risks to the performance of the Lifemark Portfolio, despite becoming increasingly aware of the severe risks affecting the Lifemark Portfolio; and

(c) deliberately misled the Authority by representing to the Authority in a compelled interview that there had never been a problem with the income payments on the SLS Products, and in a further compelled interview that the Products (SLS and Lifemark) were on target to meet their obligations, despite being aware that there had previously been problems with the income payments, that there was considerable doubt about whether SLS would make income payments and of the severe liquidity and other risks with the Lifemark Portfolio.

(2) failed to deal with the Authority in an open and cooperative way, in breach of Statement of Principle 4, in that he:

(a) made misleading representations to the Authority in two compelled interviews;

(b) misled the Authority at a meeting by withholding from the Authority the problems with the performance of the Products of which he was aware;

(c) was aware that a spreadsheet provided by Keydata to the Authority on 5 June 2009, by an email from Keydata's solicitors which was copied to him, was likely to mislead the Authority by representing that future income was expected from SLS, and failed to correct the information provided; and

(d) failed to notify the Authority at any stage: that the SLS Products were not performing and that there was a risk of failure of the SLS Portfolio; of the failure of Keydata to address its professional advisers' concerns over the due diligence for the Lifemark Products and the financial promotions for the Products; or of the risk that the Lifemark Portfolio might not perform as investors expected.

(3) recklessly failed to take adequate steps to prevent Keydata from continuing to market and sell the Lifemark Products as fulfilling the conditions set out in the ISA Regulations, when he was aware that it was highly likely that they did not do so.

2.6. The Authority considers that Mr Johnson's failings in this regard are of the most serious nature in light of the significant level of consumer detriment which has arisen from the sales of the Products and the impact which this level of consumer detriment has had on the financial services sector. During the Relevant Period over 37,000 investors purchased the Products, investing over £475 million, and the FSCS has subsequently made payments to investors in the Products of over £330 million.

2.7. The Authority considers that Mr Johnson's conduct demonstrates that he is not fit and proper to perform any function in relation to any regulated activity carried on by an authorised person, exempt person or exempt professional firm.

2.8. The Authority considers that the nature and seriousness of Mr Johnson's misconduct warrant the action set out at section 1 above.

## 3. DEFINITIONS

3.1. The following definitions are used in this Final Notice:

(a) "2008 Actuarial Review" means the final text of the actuarial review conducted by the Lifemark Actuary described in paragraph 4.55;

(b) "the Act" means the Financial Services and Markets Act 2000;

(c) "the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority;

(d) "Brochure Advice" has the definition set out in paragraph 4.31;

(e) "CEO" means Chief Executive Officer;

(f) "CRT" means CRT Capital Investment Banking Group, an SEC regulated firm;

(g) "DEPP" means the version of the Decision Procedure and Penalties Manual section of the Handbook which was in force up to and including 5 March 2010;

(h) "DIP" means the Defined Income Plan;

(i) "Draft Lifemark Valuation Report" has the definition set out in paragraph 4.51;

(j) "EG" means the Authority's Enforcement Guide;

(k) "ENF" means the Authority's Enforcement Manual, which was in force between 1 December 2004 and 27 August 2007;

(l) "exempt professional firm" means a person to whom, as a result of Part XX of the Act, the general prohibition does not apply in relation to that activity;

(m) "February 2008 Brochure Report" has the definition set out in paragraph 4.37;

(n) "FIT" means the Fit and Proper Test for Approved Persons section of the Handbook;

(o) "FSCS" means the Financial Services Compensation Scheme;

(p) "Handbook" means the Authority's Handbook of Rules and Guidance;

(q) "HMRC" means Her Majesty's Revenue and Customs;

(r) "IFA" means Independent Financial Adviser;

(s) "ISA" means Individual Savings Account;

(t) "ISA Regulations" means the Individual Savings Account Regulations 1998 (SI 1998/1870);

(u) "June 2008 Extract Review" has the definition set out in paragraph 4.44;

(v) "Keydata" means Keydata Investment Services Limited;

(w) "Lifemark" means Lifemark SA;

(x) "Lifemark Actuary" means the actuary for the Lifemark Portfolio;

(y) "Lifemark Bonds" means the bonds issued by Lifemark;

(z) "Lifemark Companies" means the various companies within the Lifemark structure described in paragraph 4.17 of which Mr Ford personally and/or his family, through trusts he set up on behalf of his family, were the beneficial owner(s) or from which they were entitled to the full benefit;

(aa) "Lifemark Investment Manager" means the investment manager appointed to manage the Lifemark Portfolio;

(bb) "Lifemark Portfolio" means the portfolio of US senior life settlement policies and cash in which the funds raised from investors through the issue of the Lifemark Bonds were invested by Lifemark;

(cc) "Lifemark Products" means issue 4 of the SIB, issues 1 to 12 of the SIP, issues 1 to 12 and 14 of the Income Plan and issues 1 to 9 of the DIP;

(dd) "Luxembourg Regulator" means the Commission de Surveillance du Secteur Financier, the Luxembourg financial regulator;

(ee) "March 2008 Due Diligence Report" has the definition set out in paragraph 4.40;

(ff) "October 2008 Lifemark Report" has the definition set out in paragraph 4.55;

(gg) "Offshore Arranger" means the company, incorporated in the British Virgin Islands, which was party to a Professional Services Agreement dated 16 October 2006 with Lifemark relating to services including the negotiation of contracts, introductions and support for operational matters in relation to the Lifemark Portfolio;

(hh) "Offshore Consultancy" means the company, incorporated in the British Virgin Islands, which entered into a fee sharing agreement with a US originator of life settlement policies for purchase by Lifemark;

(ii) "Offshore Partnership" means the offshore partnership, with which Mr Ford was a consultant, which carried out services for Keydata in relation to the SLS Products and was subsequently engaged by Keydata to negotiate and control the activities of all parties to the Lifemark Bonds, pursuant to a Corporate Management Services Agreement dated 25 May 2007 with Keydata;

(jj) "Offshore Promoter" means the company, incorporated in Panama, which was party to a promotion and distribution agreement with Lifemark dated 17 March 2006 in relation to the Lifemark Bonds;

(kk) "Products" means the SIB, the SIP, the Income Plan and the DIP;

(ll) "RAC" means Required Asset Cover;

(mm) "Relevant Period" means the period from 26 July 2005 to 8 June 2009;

(nn) "SIB" means the Secure Income Bond;

(oo) "SIP" means the Secure Income Plan;

(pp) "SLS" means SLS Capital SA;

(qq) "SLS Bonds" means the bonds issued by SLS;

(rr) "SLS Investment Manager" means the investment manager appointed to manage the SLS Portfolio;

(ss) "SLS Portfolio" means the portfolio of US senior life settlement policies and cash in which the funds raised from investors through the issue of the SLS Bonds were invested by SLS;

(tt) "SLS Products" means issues 1, 2 and 3 of the SIB;

(uu) "Statement of Principle" means one of the Authority's Statements of Principle for Approved Persons in the Handbook;

(vv) "Summary Report" has the definition set out in paragraph 4.43; and

(ww) "the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber).

## 4. FACTS AND MATTERS

### Keydata

4.1. Keydata was the wholly owned subsidiary of Keydata UK Limited, a company incorporated in Scotland. Mr Johnson had a small shareholding in Keydata UK Limited. Keydata had permissions under Part IV of the Act to carry on regulated activities and was therefore an "authorised person" as defined in section 31 of the Act.

4.2. Keydata designed, launched and, via IFAs, distributed structured investment products to retail customers. It launched its first investment products in 2001. The majority of Keydata's products were structured products involving the purchase of bonds and it offered a range of five to six such products at any one time. As at June 2009 Keydata had £2.8 billion of investment products under administration (including £2.1 billion of assets held on behalf of major financial services firms whose products Keydata administered).

4.3. Keydata's business in relation to the Products was primarily managed and controlled by Stewart Ford, who held, among other controlled functions, Controlled Function 3 (Chief Executive) (which he held throughout the Relevant Period). Mr Ford sought to resign from his position as CEO of Keydata during 2007 and entered into a Non-Executive Service Agreement with Keydata dated 19 July 2007, which described him as a non-executive director. That agreement provided that Mr Ford was not expected to devote more than 20 hours per month to Keydata's business. However, Mr Ford did not notify the Authority of his purported resignation, he continued to hold Controlled Function 3, nobody replaced him as Keydata's CEO, and he continued to be regarded by Mr Johnson and the other Keydata directors as Keydata's CEO. The Authority therefore considers that Mr Ford was Keydata's CEO throughout the Relevant Period. Mr Ford was also a director and the majority shareholder and controller of Keydata UK Limited.

**The SLS Products**

4.4. The SLS Products were underpinned by investments in bonds issued by SLS. They were promoted to investors as being eligible for ISA status. SLS was a special purpose vehicle incorporated in Luxembourg. The SLS Bonds were purchased by Keydata on behalf of investors in the SLS Products. From 26 July 2005 to 16 December 2005 £103 million was invested in the SLS Products by 6,486 retail investors, via IFAs.

4.5. The funds in the SLS Bonds were invested in US senior life settlement policies and cash, which comprised the SLS Portfolio. The reason for keeping a portion of the investments in cash was to fund the payment of fees, income and insurance premiums. The investment mix for the SLS Portfolio was intended to be 60% policies and 40% cash for the SLS Products. The policies and cash were intended to produce income and a full return of capital at the end of the term of the SLS Product (through the death of an insured individual or the re-sale of the policy in the secondary market), although the return of capital was not guaranteed. The terms of the SLS Products were intended to mirror the terms and conditions of the SLS Bonds; for example the SLS Bonds paid income quarterly or annually (which was mirrored by the investment options available for the SLS Products, although the SLS Products had lower income rates than the SLS Bonds).

4.6. The investors did not pay a fee to Keydata in respect of the investment in the SLS Products. Keydata received an initial commission from SLS which was 5.5% of the total funds invested in the SLS Products. This was not disclosed to investors (and there was no requirement for it to be disclosed). Keydata retained 2.5% of

the initial commission and paid 3% on to IFAs. Keydata also received quarterly fees from SLS in respect of each of the SLS Products. These payments amounted to 1.81% per annum of the funds invested in the SLS Products. In addition, SLS paid Keydata 0.5% in annual trail commission which Keydata paid on to IFAs. The total amount of the fees and commission paid by SLS to Keydata in relation to the SLS Products was £5,426,707.

4.7. Prior to September 2007 the shareholders of SLS included CRT and BWT Capital, of which David Elias, a British businessman based in Singapore, was the beneficial owner. However, from September 2007 Mr Elias became the sole beneficial owner of SLS as a result of a company owned by him purchasing CRT's shares in the company. It was reported in the press that Mr Elias died in Singapore on 8 May 2009.

4.8. The SLS Products were high risk in nature and as such the returns offered to investors, both in respect of income and the return of capital at maturity, would be subject to a high level of risk. The high risk nature of the SLS Products resulted from the following:

(1) the SLS Portfolio invested in assets which were highly illiquid and very expensive to maintain. The costs of funding the premiums for the policies were extremely high and failure to make these payments would result in the policies lapsing and all capital value being lost; and

(2) the performance of the SLS Portfolio (and therefore the returns to investors) was dependent on the date of death of the individuals insured under the senior life settlement policies occurring broadly in line with the forecast life expectancies.

4.9. The SLS Portfolio operated on the basis of a 2:1 RAC ratio. In respect of all the SLS Products this meant that the face/maturity value of the policies purchased should at all times be at least twice the amount of the principal outstanding on the SLS Bonds (the amount of subscription monies invested) minus cash. For example, if the face value of the SLS Portfolio was £20 million and the principal amount outstanding under the SLS Bonds was £5 million with a cash surplus of £1 million, this RAC ratio would be met as the RAC calculation would be 20 ÷ (5 - 1) = 5.

4.10. On 17 April 2008, SLS entered into an agreement with a company connected with Mr Elias under which all the policies in the SLS Portfolio and other assets of SLS

were transferred to that company in return for a guarantee in relation to SLS's liabilities. From that date, the guarantee was the only asset in the SLS Portfolio; however, RAC certificates were issued subsequently, indicating that the RAC ratio was being met even though there was, from that date, no proper basis for such certificates to be issued. Neither Keydata nor Mr Johnson were involved in, or informed at the time of, the arrangements between SLS and the guarantor to put in place the guarantee. SLS was put into liquidation on 1 October 2009.

**The Lifemark Products**

4.11. Following the launch of the SIB 3, Keydata was advised by CRT that it would not support any further issues of the SIB. The SIB 3 closed to retail investors on 16 December 2005 and, on 19 December 2005, Keydata instead started to launch the Lifemark Products, which were underpinned by investments in bonds issued by Lifemark, and which were also promoted to investors as being eligible for ISA status. Lifemark was a special purpose vehicle incorporated in Luxembourg on 12 January 2006 and regulated by the Luxembourg Regulator. Lifemark was set up by Mr Ford who was also one of its directors.

4.12. Mr Ford advised the Authority that he had been required to be a director of Lifemark by the Luxembourg Regulator as it wished Lifemark to have a representative of Keydata on its board of directors. While this was correct, the Authority discovered after Keydata went into administration that Lifemark was also beneficially owned by Mr Ford through a structure under which the assets were held by a Dutch "stichting" or trust arrangement set up on his behalf. Mr Ford had no formal control over the actions of the trustees but in practice they would act in accordance with his instructions. Under this arrangement, Mr Ford would have benefited from any residual value in the assets of Lifemark once all holders of the Lifemark Bonds had been paid in full.

4.13. The Lifemark Bonds were purchased by Keydata on behalf of investors in the Lifemark Products. Keydata designed, marketed and sold over 30 issues of the Lifemark Products from 19 December 2005 to 8 June 2009. £373,162,684 was invested in the Lifemark Products by 30,906 retail customers, via IFAs.

4.14. The funds in the Lifemark Bonds were invested in US senior life settlement policies and cash, which comprised the Lifemark Portfolio. The investment mix for the Lifemark Portfolio was intended to be 70% policies and 30% cash for the Lifemark Products. The policies and cash were intended to produce income and a full return of capital at the end of the term of the Lifemark Product (through the death of an

insured individual or the re-sale of the policy in the secondary market), although the return of capital was not guaranteed. The terms of the Lifemark Products were intended to mirror the terms and conditions of the Lifemark Bonds.

4.15. The investors did not pay a fee to Keydata in respect of the investment in the Lifemark Products. Keydata was entitled under an agreement with Lifemark to a 2.5% upfront commission on the funds invested in each Lifemark Product and a 1% per annum ongoing trail commission (this does not include any fees and commissions received by Keydata from Lifemark and passed on to IFAs). The commissions paid by Lifemark to Keydata up to 8 June 2009 in relation to the Lifemark Products totalled £22,791,932 (excluding fees and commissions passed on to IFAs).

4.16. The Lifemark Products were high risk in nature and as such the returns offered to investors, both in respect of income and the return of capital at maturity, would be subject to a high level of risk. The high risk nature of the Lifemark Products resulted from the following:

(1) the Lifemark Portfolio invested in assets which were long-term, highly illiquid and very expensive to maintain. The costs of funding the premiums for the policies were extremely high and failure to make these payments would result in the policies lapsing and all capital value being lost;

(2) the Lifemark Portfolio was not in existence when the Lifemark Products were launched and therefore it would take some time for the Lifemark Portfolio to reach the required size where it would be self-funding (i.e. policy maturities were able to fund the premium payments and obligations under the Lifemark Bonds). This meant that Lifemark needed to have the ability to continue to issue the Lifemark Bonds or raise funds by other means, including borrowing, until such time as the Lifemark Portfolio became self-funding; and

(3) the performance of the Lifemark Portfolio (and therefore the returns to investors) was dependent on the deaths of the individuals insured under the US senior life settlement policies occurring broadly in line with the forecast life expectancies.

4.17. In addition to his beneficial ownership of Lifemark, Mr Ford personally and/or his family, through trusts he set up on behalf of his family, were the beneficial

owner(s) of, or entitled to the full benefit from, the Lifemark Companies, which comprised:

(1) the Offshore Promoter, which was paid fees of £5,283,739 under its agreement with Lifemark, which provided for it to "*promote and distribute the asset backed securitization bonds being issued from time to time by Lifemark*";

(2) the Offshore Consultancy, which was paid fees of £31,106,469 by US brokers for introductory services in respect of the sale of US senior life settlement policies to Lifemark; and

(3) the Offshore Arranger to which Lifemark agreed to pay 10% of the funds invested in the Lifemark Bonds pursuant to a Professional Services Agreement dated 16 October 2006 in return for the provision of a number of services including: the negotiation of contracts with "*investment activity parties*" and "*administration parties*"; the provision of "*introductions to distribution opportunities*" and advice on "*distribution opportunities to allow* [Lifemark] *access to key distribution opportunities*"; and the provision of support to Lifemark's contract counterparties for operational matters. Lifemark paid fees to the Offshore Arranger of £36,074,852.

4.18. As set out above, the Lifemark Companies took over £72.4 million from the Lifemark structure (a sum equivalent to 19.4% of all the investment funds invested in the Lifemark Products). The Authority considers that the Lifemark Companies performed no, or no meaningful, services in return for the sums received by them in respect of their involvement in the Lifemark structure.

4.19. The risk to investors in the Lifemark Products of not receiving the returns promised was made considerably more likely by the very high level of fees paid to Keydata and the Lifemark Companies (see paragraphs 4.15 and 4.17 above). The Provisional Administrator of Lifemark stated in his report to the Luxembourg Regulator that:

(1) the level of fees payable under the Lifemark structure, a number of which were undisclosed and paid to companies owned or controlled by Mr Ford, was directly responsible for the failure of Lifemark: "*the current model was torpedoed by the high cost structure, which prevented Lifemark from reaching the required level of assets in light of its debts*"; and

(2) Lifemark had a liquidity problem:

> "*It could be thought that Lifemark issued bonds each time liquidity was at risk. This situation was inevitable given the significant fees which had been paid. …. If the fees had been less significant, then the available funds would normally have been used to:*
>
> *- retain a cash reserve, as provided for in the general conditions*
>
> *- acquire more policies (which would therefore potentially have generated more mortalities and therefore more revenue)*
>
> *In simple terms, the initiators probably pushed their luck a bit too much and the survival link became considerably weaker".*

4.20. The Lifemark Portfolio operated on the basis of a 2:1 RAC ratio (which is described at paragraph 4.9 above in relation to the SLS Portfolio). The Luxembourg Regulator closed Lifemark to new business in mid-2009 and Lifemark was subsequently put into administration and, on 11 May 2012, liquidation.

**Failure of the SLS Products to perform**

4.21. Mr Johnson was aware from 13 November 2006 that there were problems with the performance of the SLS Portfolio, and accordingly that there could be problems with the SLS Products.

4.22. On 13 November 2006 Mr Ford attended a conference call with the Offshore Partnership and the SLS Investment Manager. Mr Johnson received a copy of an email dated 13 November 2006 from the Offshore Partnership reflecting the content of that call, namely that the SLS Investment Manager advised that the RAC ratio for the SLS Portfolio was (in breach of the terms and conditions of the SLS Bonds) at 1.91:1 rather than the required 2:1 and that the SLS Bonds were likely not worth par at that time (i.e. investors would receive less than £1 for each £1 invested). The fact that the SLS Portfolio had breached the RAC ratio resulted in the non-payment of income owing under the SLS Bonds. These income payments were in turn used to fund the income payable under the SLS Products and fees to Keydata and IFAs.

4.23. On 6 January 2007 the Offshore Partnership informed Mr Ford that it had been told

of a rumour that *"SLS will go into default in the next 20 days. This means that income payments will stop and capital will be recovered on a partial basis".* Mr Ford forwarded this email to Mr Johnson on 8 January 2007 and Mr Johnson responded that *"This e mail puts me in a difficult position as if it is fact I am duty bound as Compliance Officer to report this to the* [Authority]*, which would present all kinds of potential problems. It also presents me with a serious conflict of interest. I have asked* [the Offshore Partnership] *whether the e mail is fact or rumour and* [the Offshore Partnership] *confirms that it is rumour at this stage, which means that I do not have to report it".*

4.24. On 12 February 2007 Mr Johnson wrote to Mr Ford: *"I think we need to ensure that we put steps in place to rectify the position with* [SLS] *asap. I have discussed this with* [the Offshore Partnership] *and we think it would be best if Lifemark "took over"* [SLS]*. If this is what is decided we need to instruct* [the Offshore Partnership] *to proceed with matters".*

4.25. On 16 April 2007 the Offshore Partnership attended a conference call with the SLS Investment Manager to discuss, among other things, the failure of SLS to make an income payment in respect of the SLS Bonds which underpinned the SIB 3. On 26 April 2007 Mr Johnson received an attendance note of the call in which it was noted that the SLS Investment Manager had advised the Offshore Partnership that this payment was missed due to the failure of the SLS Portfolio to meet the RAC ratio.

4.26. On 17 April 2007 Mr Johnson sent an email to the Offshore Partnership and Mr Ford relating to the fact that an income payment for the SIB 3 had not been made and Keydata was funding the payment: "*Funding is coming from* [the Keydata Finance Director]. *Definitely a worrying set of events, I am concerned it may be something that is something we have to disclose to clients!*"

4.27. On 2 April 2008 Mr Johnson was made aware that Keydata was considering funding the income payment for the SIB 1 that SLS had failed to pay. He referred the matter to Mr Ford.

4.28. On 30 July 2008 Mr Johnson received an email from the Offshore Partnership confirming that the income due on 14 July 2008 for the SIB 3 was late and that SLS did not have to pay until two months after the due date according to the terms and conditions.

4.29. On 1 August 2008 Mr Johnson sent an email to Mr Ford and the Keydata Sales

Director confirming that income on the SLS Bonds was not payable for 59 days after it was due, suggesting that the July 2008 SIB 3 payment still had not been paid.

4.30. Mr Johnson was not aware of the detailed discussions which took place in 2007 and 2008 between Mr Ford, Mr Elias and the Offshore Partnership concerning the deteriorating state of the SLS Portfolio. However, as set out above, Mr Johnson was aware that the SLS Products were not performing and that there was a risk of failure of the SLS Portfolio. In addition, he was aware that investors, IFAs and the Authority were not aware of these matters, but failed to notify the Authority.

**Financial promotions for the Products**

4.31. In late 2005 Keydata instructed its legal advisers to assess the brochures for the SLS Products for the purposes of compliance with the Authority's financial promotion rules. Mr Johnson received the final written advice from Keydata's legal advisers on 5 December 2005 (the "Brochure Advice").

4.32. The Brochure Advice stated: *"[a]s currently drafted we think the SIB brochures are not sufficiently* compliant *with the* [Authority's] *financial promotion rules and we think the brochure should not be used until certain amendments have been made".*

4.33. In particular the Brochure Advice stated that the comparison between the SIB and other income products (for example a bank account) lacked sufficient clarity and had the effect of suggesting that the risk of the SIB was *"low per se, which is not strictly accurate".* The Brochure Advice also pointed out that the brochures for the SLS Products did not adequately set out the risks of the investment, as the section entitled *"Is there any risk?"* was not comprehensive and later in the Key Features documents other risks were mentioned.

4.34. From 19 December 2005 Keydata issued financial promotions for the Lifemark Products which were materially similar in content to those for the SLS Products, despite the Brochure Advice, and were unclear, incorrect and misleading in a number of areas:

(1) the brochures for the Lifemark Products did not adequately explain the risks associated with the operation of the products. For example: that the Lifemark Products were inherently high risk, contrary to the brochures which stated that they were "*lower risk*" in comparison to other types of investments such as equities; that both income and capital were at risk;

that the date of maturity of the policies in the Lifemark Portfolio was entirely uncertain; that the information about the projected future performance of the products was not based on reasonable assumptions supported by objective data, nor was it made clear that a forecast is not a reliable indicator of future performance; and that the risk warnings that were given were misleading and were often undermined by positive language or by their positioning;

(2) a number of the brochures for the Lifemark Products failed to disclose the currency risk as one of the risks of the Product. The lack of a currency hedge would affect the valuation of the Lifemark Products upon redemption or maturity and the currency risk was an unknown quantity. However, the contractual arrangements to secure a currency hedge were not in place (from the launch of the Lifemark Products and the issue of the brochures) to mitigate the foreign exchange risk inherent in the Lifemark Products. Hedging arrangements using a US dollar to pound sterling currency swap were later put in place, between late 2007 and early 2008;

(3) the brochures for the SIB 4 contained references to the existence of a credit facility to provide the Lifemark Portfolio with liquidity funding to enable it to continue to pay the premiums due on the senior life settlement policies comprising the Lifemark Portfolio in the event that they did not generate a sufficient return to fund these expenses. No such credit facility was in place; and

(4) the brochures for each of the SIB 4, SIP 1 to 4 and the DIP 1 to 8 stated that the investment was into a bond listed on the Luxembourg Stock Exchange and that this would make the Product eligible for ISA status. The SIB 4 and the SIP 1 to 4 (which were issued between 19 December 2005 and 31 July 2006) were not listed on the Luxembourg Stock Exchange until 6 June 2007 and the DIP 1 to 8 (which were issued between 5 March 2008 and 12 January 2009) were not so listed until 24 June 2009.

4.35. As Keydata's Compliance Officer, Mr Johnson was responsible for signing off the financial promotions issued by Keydata for the Lifemark Products and was ultimately responsible for ensuring that they were clear, fair and not misleading. Mr Johnson was responsible for ensuring that every statement in Keydata's financial promotions for the Lifemark Products that purported to be a statement of fact was accurate and that Keydata could demonstrate why it believed the factual statement was accurate.

4.36. Mr Johnson approved brochures for the Lifemark Products that he should have known were misleading because they were materially similar in content to those for the SLS Products and therefore were non-compliant for the reasons stated in the Brochure Advice.

4.37. On 7 February 2008 Mr Johnson received a review of the contents of the brochure for the SIP 14 from one of Keydata's professional advisers (the "February 2008 Brochure Report"). This advised: "[w]*e believe that the way this information is presented is not clear or fair enough and that it does not meet the standards applied by the* [Authority] *or the industry generally…. A number of the individual points we have raised may not seem that significant in isolation*. *Taken together, though, the effect is sufficiently serious that you should consider suspending sales on the basis of this material*".

4.38. Following receipt of the February 2008 Brochure Report, on 19 February 2008 Mr Johnson informed Mr Ford and Keydata's Sales Director that Keydata's professional advisers had advised Keydata to "*not issue SIP 15 until we receive the extra due diligence*". Keydata did not issue any further issues of the SIP. Instead, it renamed the product through which it offered investments in Lifemark as the DIP. The DIP was in all material respects an identical product to the SIB 4 and the SIP. In an email to IFAs Keydata described it as a "*replacement product*" for the SIP, which "*has been set up in exactly the same way and utilises the same robust investment process and criteria as the SIP*".

4.39. Keydata developed and packaged the Lifemark Products, produced promotional material and selected the IFAs who were to market them, and therefore had responsibility for (among other things): having systems and controls to manage adequately the risks imposed by the product design; and, when providing information to distributors, ensuring the information was sufficient, appropriate and comprehensible in substance and form, including considering whether it would enable distributors to understand it enough to give suitable advice (where advice was given) and to extract any relevant information and communicate it to the end customer.

4.40. The Authority considers that Keydata's due diligence into the Lifemark Products was limited and was not completed prior to the launch of the Lifemark Products. On 3 March 2008 Mr Johnson received a copy of advice from one of Keydata's professional advisers (the "March 2008 Due Diligence Report") which concluded that Keydata's due diligence in relation to the SIP was inadequate and incomplete.

The March 2008 Due Diligence Report concluded that Keydata's due diligence did not evidence:

(1) the roles of, or contractual arrangements with, various counterparties within the Lifemark structure;

(2) the terms, including the impact and cost, of any currency hedge;

(3) whether Keydata had tested whether the rates of return on the Lifemark Products were achievable or the risk parameters within which they were achievable and the costs which were payable under the Lifemark structure;

(4) whether Keydata had considered all the risks to the return of investor capital; and

(5) what protections existed within the Lifemark Portfolio to deal with a cross-subsidy risk: "*In the event that losses are suffered, it is not clear from the papers whether any procedures exist to ensure that investors in earlier issues would not receive returns at the expense of investors in later issues*".

4.41. Further, the March 2008 Due Diligence Report advised Keydata that while it was not possible to be definitive about the quantity or nature of the due diligence required, "*as a high level indicator*", as Keydata was "*marketing and distributing this complex offshore product to UK investors who are generally unable to penetrate the product's structures*", its due diligence should have been sufficient to:

(1) "*be assured that the product will, in the normal course of events and within reasonable parameters, perform as intended*";

(2) "*be able to describe those characteristics and risks to potential investors in terms that are clear, fair, not misleading and are likely to be understood by potential investors*"; and

(3) "*enable the directors to explain the characteristics and risks and to describe and evidence the processes that have been put in place to manage those risks*".

4.42. The March 2008 Due Diligence Report concluded that a number of Keydata's failings in respect of its due diligence were connected to potentially misleading

statements in its financial promotions. For example:

(1) in order to ensure that the principal risks to the Lifemark Products were adequately explained in the brochures Keydata should undertake (or commission a third party to undertake) some additional work to:

(a) model the Lifemark Products – to show the expected returns "*allowing for all charges deducted by the various parties at each stage*";

(b) run a number of test scenarios to assess the probability of investor capital being returned in full: "*Keydata then needs to demonstrate that the probability of investor expectations not being met is acceptably low and is presented appropriately in promotions*";

(c) obtain quarterly valuations of the Lifemark Portfolio on a market value basis;

(d) regularly review the actuarial model "*especially before embarking on a series of purchases or sales*" from the Lifemark Portfolio;

(e) review the currency hedging arrangements: "*check that these are appropriate to the underlying risks and that the underwriting organisation has the financial strength to honour its obligations. If the whole currency risk is not hedged, assess the probability of exchange impairment and whether this is acceptable*"; and

(f) address a concern about cross-subsidy between investors: "*as all assets are held in one fund and the demarcation of assets between tranches of business is opaque, Keydata should consider how the demarcation operates and how it can ensure and demonstrate that final payouts to investors are a true reflection of the assets held on their behalf*";

(2) references in the brochures were unsubstantiated: "*We note also that Keydata's marketing material* [in fact, only the brochure for the SIB 4] *referred to a bank overdraft facility. We have not seen any papers relating to the overdraft facility and so we recommend that any such arrangements should be properly documented, as it has been alleged that this facility is available to provide liquidity in adverse trading conditions"*.

4.43. Following the March 2008 Due Diligence Report Keydata obtained a series of reports by the Lifemark Investment Manager, including a summary report dated 31 March 2008 (the "Summary Report"). The Summary Report was provided by Keydata to its professional advisers to address the matters raised in the March 2008 Due Diligence Report. On 16 April 2008 Mr Johnson was provided with a copy of Keydata's professional advisers' review of the Summary Report. Keydata's professional advisers concluded that the Summary Report did not provide enough information to deal with their concerns raised in the March 2008 Due Diligence Report, stating "*In our view, none of the recommendations in our report have been* addressed *adequately in this document.*" The professional advisers recommended that Keydata address each of the outstanding matters, but Keydata did not do so.

4.44. Keydata's professional advisers issued a further report to Keydata on 18 June 2008 (the "June 2008 Extract Review") which considered a report Keydata had obtained on the Lifemark Portfolio. Mr Johnson saw a copy of this report on 19 June 2008. In the June 2008 Extract Review the professional advisers advised Keydata that they agreed with the professional firm that had written the report on the Lifemark Portfolio that the number of senior life settlement policies within the Lifemark Portfolio (229 lives) was small, and commented that this "*directly contradicts assertions made by Keydata in its financial promotions for the SIP that the portfolio contains a large pool of lives and is therefore less exposed to the random fluctuations associated with small pools of lives*".

4.45. As Keydata's Compliance Officer, Mr Johnson should have made it clear to the Keydata board of directors that, in order to comply with its regulatory duties, Keydata should take the steps recommended by its professional advisers to address the deficiencies identified in the February 2008 Brochure Report, the March 2008 Due Diligence Report and the June 2008 Extract Review, including amending its financial promotions, and stop selling or marketing the Lifemark Products until those steps had been taken.

4.46. However, Mr Johnson failed to take adequate steps to ensure that the Keydata board of directors committed Keydata to taking these steps. Keydata continued to market the SIP 14 on the basis of the unamended brochure which was the subject of the February 2008 Brochure Report and allowed investors who had already agreed to invest in the SIP 14 to be placed into it until it closed to investment on 22 February 2008. Keydata then marketed the Income Plan 12 and 14 and the DIP 1 to 9 after 3 March 2008 by issuing financial promotions which were materially similar in content to those for the earlier Lifemark Products. The

DIP 1 and Income Plan 12 were launched on 5 and 7 March 2008 respectively. Mr Johnson was aware that the Keydata board of directors had not committed Keydata to taking the steps recommended by its professional advisers and he failed to take adequate steps to stop Keydata from continuing to market and sell the Lifemark Products until it had made the necessary amendments to its financial promotions.

**The risk of failure of the Lifemark Products**

4.47. On 23 May 2007 Mr Johnson received from the Lifemark Investment Manager a Lifemark Portfolio forecast which predicted that if only 30% of investors in the Lifemark Products rolled over their investments at the end of the term into new investments in Lifemark Products, the Lifemark Portfolio would face a deficit of US$35 million in 2011, which was the time the Lifemark Products would start to mature.

4.48. In light of this information, Mr Johnson would have been aware of the significance of the rollover rate and the need for Keydata to take steps to manage the risk that the proportion of investors rolling over their investments would be insufficient to avoid the Lifemark Portfolio facing a deficit, but he took no steps to ensure that Keydata managed this risk.

4.49. On 12 March 2008 Keydata was provided with the first of the Lifemark Investment Manager's reports mentioned in paragraph 4.43. This report was based on a 0% rollover assumption. It indicated that the Lifemark Portfolio could not return investors' capital in full unless a number of steps were taken, including ensuring that a low interest credit facility was put in place, and that there were cross-subsidy concerns about investors buying different Lifemark Products at different times. The Lifemark Investment Manager concluded that "*If the portfolio is maintained using a buy and hold strategy, we expect that the* [Lifemark] [P]*ortfolio will experience a negative cumulative cash flow at year end 2009 of ($6,567,351) and will continue to be impacted negatively at an increasing rate until year 2014*". Mr Johnson commented that: "*In conclusion, the report does not give me any comfort that the* [Lifemark] *Investment Manager is in control of the Investment Management process!*"

4.50. As mentioned in paragraph 4.43, Keydata sought its professional advisers' views on the Summary Report. Keydata's professional advisers raised a number of queries (through Mr Ford) with the Lifemark Investment Manager. These queries focused on the performance of the Lifemark Portfolio, currency risk and cross-

subsidy concerns. In their review of the Summary Report, a copy of which was received by Mr Johnson on 16 April 2008, the professional advisers concluded that the report *"suggests that the portfolio will experience negative cashflow but no arrangements are currently in place to address this".* Mr Johnson was therefore aware that the Lifemark Investment Manager had predicted that the Lifemark Portfolio faced a liquidity problem and that no credit facility was in place to deal with this.

4.51. On or around 30 May 2008 Mr Johnson was aware of the existence and contents of a draft valuation of the Lifemark Portfolio (the "Draft Lifemark Valuation Report") provided to Keydata by the Lifemark Actuary. The Draft Lifemark Valuation Report projected that the Lifemark Portfolio would face a deficit of approximately US$172 million to US$84 million between 2011 and 2013 and stated that the number of lives in the Lifemark Portfolio was small. It confirmed that any deviations from its assumptions in respect of currency rates, interest rates or life expectancies could have a significant impact on the overall profitability of the Lifemark Portfolio.

4.52. On 19 June 2008 Mr Johnson received Keydata's professional advisers' review of the information regarding the SIB and SIP provided to the Authority by Keydata on 21 May 2008 in response to statutory information requirements. Keydata's professional advisers advised Keydata that the RAC ratio was a "*red herring*", and that a more useful indicator of value would be the market value of the policies within the portfolio versus the obligations owed under the relevant bonds. Keydata's professional advisers also commented that the SLS Portfolio was very small in size and that "*luck will play a key role unless Lifemark/Keydata insures against light mortality*".

4.53. The June 2008 Extract Review, also received by Mr Johnson on 19 June 2008, concluded that:

(1) the extract would "*lead an informed reader to conclude that the probability of Keydata meeting investors' expectations is not better than 50:50, and potentially a lot less*";

(2) the number of senior life settlement policies within the Lifemark Portfolio (229 lives) was small; and

(3) "*Lifemark will have to sell a significant proportion of the policies to meet redemption payments, and it is therefore materially exposed to*

*market conditions at that time, costs of disposal and changes to mortality assumptions*".

4.54. During July 2008 Mr Johnson was aware that Keydata had amended and approved the Lifemark Investment Manager's update on the Lifemark Portfolio (which was produced every six months) which stated that the Lifemark Portfolio was "*expected to provide a steady stream of returns covering the bond coupon payments as well as the return of principal and capital to bond investors in a timely manner*". Mr Johnson had good reason to doubt that the Lifemark Investment Manager's update gave an accurate impression of the risks to the performance of the Lifemark Portfolio in light of the various reports produced by the Lifemark Investment Manager, the Draft Lifemark Valuation Report and the June 2008 Extract Review. Mr Johnson was aware that Keydata circulated the Lifemark Investment Manager's update to IFAs on or around 25 July 2008. Mr Johnson failed to take adequate steps to ensure that this update gave an accurate impression of the risks to the performance of the Lifemark Portfolio.

4.55. On 3 November 2008 Keydata, by an email copied to Mr Johnson, provided its professional advisers with a further report by the Lifemark Investment Manager dated 30 October 2008 (the "October 2008 Lifemark Report"), which considered a draft of an actuarial review conducted by the Lifemark Actuary dated 12 October 2008. This report concluded that the Lifemark Portfolio would face a very significant negative cash balance between 2009 and 2014 (during which time the majority of the Lifemark Products would be due to mature) that would peak at minus $196 million, and that thereafter the cumulative cashflow of Lifemark would be negative until 2023 but the Lifemark Portfolio would hold a positive cash balance at 2027. The Lifemark Investment Manager expressed the view that the Lifemark Portfolio could meet all of its obligations and that the risk to bondholders' capital was minimal.

4.56. On 4 December 2008 Mr Johnson received a report from Keydata's professional advisers which concluded that the October 2008 Lifemark Report raised concerns that the Lifemark Investment Manager did not understand the Lifemark Products and contained "[a] *lot of negatives; lack of understanding, holes in logic and warning signs*". Keydata's professional advisers concluded that the October 2008 Lifemark Report "*could (or should) lead a reader to question the viability of the product*".

4.57. At no time during the Relevant Period did Mr Johnson:

(1) take adequate steps to ensure the Keydata board of directors committed Keydata to taking effective action to manage the risks that had been clearly identified by Keydata's advisers (including those arising out of its inadequate due diligence for the Lifemark Products) and which threatened the ability of the Lifemark Products to deliver the investment returns that had been promised and permit a return of capital, or consider or address the need to ensure that the Authority, investors and IFAs were notified of these risks;

(2) take adequate steps to ensure the Keydata board of directors suspended or ceased the promotion or sales of the Lifemark Products until Keydata's financial promotions were clear, fair and not misleading in all respects; or

(3) take adequate steps to ensure the Keydata board of directors considered or addressed the actions that Keydata could or should take to mitigate the potential loss to investors who had invested in the Lifemark Products.

4.58. The steps that Mr Johnson could have taken to ensure that the Keydata board of directors committed Keydata to taking these actions include: (i) refusing to sign off the financial promotions for the Lifemark Products, and/or (ii) making it clear that, if the Keydata board of directors did not commit Keydata to taking these actions, he would have no alternative but to resign from his position and/or notify the Authority of the issues.

4.59. The Authority concludes that Mr Johnson failed to take adequate steps to prevent Keydata from proceeding with the promotion and sale of the Lifemark Products to investors with a reckless disregard to the risks that they posed to such investors and the risks that had been identified by Keydata's professional advisers, and despite being aware that IFAs and investors were unaware of such risks.

4.60. As a result of the professional advice and other information that he received or was otherwise aware of, Mr Johnson could not have been in any doubt that material risks to the performance of the Lifemark Portfolio existed and needed to be addressed as a matter of urgency and that Keydata's promotional material was inadequate and incomplete. Despite this knowledge, Mr Johnson failed to take adequate steps to ensure the Keydata board of directors committed Keydata to managing such risks or ceasing to promote Lifemark Products, or that others, including the Authority, IFAs and investors, were alerted to the existence of such risks. He thereby recklessly exposed investors in the Lifemark Products to very significant risks.

**Failure of the Products to comply with the ISA Regulations**

4.61. Keydata offered the Products for investment with the benefit of a tax-efficient ISA wrapper. In order to be eligible for ISA status the Products had to comply at all times with the ISA Regulations. The ISA Regulations provided that in order to be a qualifying investment for a stocks and shares ISA the securities in question must have at least a five year investment term and must be listed on the official list of a recognised stock exchange. For the purposes of the ISA Regulations the main market of the Luxembourg Stock Exchange was a recognised stock exchange.

4.62. The brochures for the Products stated either that the relevant bonds were listed on the Luxembourg Stock Exchange or that they would be so listed and (in many cases) stated that they were therefore eligible for ISA status. However at the time the Products were sold the counterparties had not listed the relevant bonds.

4.63. Mr Johnson was aware at the time of the launch of the Products that listing was necessary to ensure that the investments were eligible for investment with an ISA wrapper. However he wrongly understood that if the relevant bonds were listed at some stage within the five year investment term of the Products, the ISA requirements would be met. Mr Johnson did not seek professional advice on this point prior to the launch of the Products.

4.64. Keydata also failed to ensure that each individual issue of the Products would comply with the requirement under the ISA Regulations that the investment had at least a five year term. In respect of one tranche of the SIB 2 the relevant SLS Bond was issued five days later than Keydata had expected, and hence had a maturity date falling less than five years after its inclusion in the relevant ISA. Keydata did not notice this mistake at the time, and it was only discovered in June 2008.

4.65. Mr Johnson was aware at the time of the launch of the SIB 1 on 26 July 2005 that the SLS Bonds were not listed on the Luxembourg Stock Exchange. He was also aware at the time of the launch of the SIB 4 on 19 December 2005 that the Lifemark Bonds were not listed on the Luxembourg Stock Exchange.

4.66. Mr Johnson was aware (even on his incorrect understanding of the ISA Regulations) that there was a risk to the ISA status of the SLS Products and the consequences of the listing not being in place. For example, on 14 November

2006 the Offshore Partnership confirmed to Mr Ford that Mr Johnson was under pressure from the Authority and that Keydata needed to obtain a prospectus for the SLS Bonds to "*protect the status of the investors for PEP & ISA investment structures*" and to "*evidence to the* [Authority] *that the bonds issued to Keydata for its SIB 1, 2 & 3 investors will be listed on the Lux SE*".

4.67. Mr Johnson was aware by 23 December 2008 (when he received a copy of a letter from the Authority to Mr Ford) that the Authority was extremely concerned by the risk of the SLS Products not fulfilling the conditions of the ISA Regulations (following Mr Johnson's confirmation during a compelled interview on 18 November 2008 that the SLS Bonds remained unlisted and that a listing was necessary to secure ISA status) and was insisting that Keydata urgently refer the matter to HMRC as the proper agency to determine the tax status of the Products. When the Authority followed this up in January 2009, however, Mr Johnson advised the Authority that Keydata would only take the matter up with HMRC once the SLS Bonds were in fact listed. The Authority advised Keydata that the delay in dealing with this matter was an unacceptable risk to retail investors and asked that Keydata consent to the Authority referring the matter to HMRC. Despite Keydata's representations to the Authority that the matter had been reported to HMRC, Keydata did not make the formal notification to HMRC until 4 March 2009. Keydata's letter of notification to HMRC acknowledged that if the relevant bonds were not listed then this would amount to a breach of the ISA Regulations.

4.68. On 22 May 2009 HMRC wrote to Keydata confirming that the SLS Bonds were not qualifying investments for an ISA and that there had therefore been a breach of the ISA Regulations. In addition, HMRC stated that the SIB 2 also breached the ISA Regulations as the SLS Bonds would mature within 5 years of the date on which they were first held in the SIB. The letter stated that as these investments were not qualifying ISA investments, any return on them was not exempt from tax and consequently HMRC would be seeking to recover the tax.

4.69. Despite being aware by 23 December 2008 that the Lifemark Products had either not been listed or had not been listed for the full five year investment term, and so it was highly likely that they failed to comply with the ISA Regulations, Mr Johnson recklessly failed to take adequate steps to ensure the Keydata board of directors committed Keydata to cease selling the Lifemark Products to investors with an ISA wrapper. On and after 23 December 2008 Keydata sold DIP 7, DIP 8 and DIP 9 to 2,213 investors, amounting to a further £18 million in ISA investment.

**Misleading the Authority**

4.70. Mr Johnson misled the Authority about the performance of the Products. Mr Johnson deliberately provided misleading answers in two compelled interviews and withheld information in a meeting. As Keydata's Compliance Officer until 1 December 2008, and as the person responsible for Keydata's dealings with the Authority in relation to the Products thereafter, it was incumbent on Mr Johnson to ensure that he provided the Authority with full and accurate information regarding the Products and their performance.

4.71. On 11 June 2008 Mr Johnson attended a compelled interview with the Authority. The Authority asked Mr Johnson if the investors in the SLS Products had been receiving interest payable to date. Mr Johnson replied "*they've had all their interest to date*" and added "*there's never been a problem with the income payments. They haven't been stopped or whatever*". Whilst it was true that investors had received all their income payments to date, it was not true that there had never been a problem with them and, as is clear from paragraphs 4.25 and 4.26, Mr Johnson was aware of this and his response was deliberately misleading.

4.72. On 18 November 2008 Mr Johnson attended a further compelled interview with the Authority. The Authority asked Mr Johnson whether the Products were performing as expected and Mr Johnson responded *"I'm told by the directors* [Mr Ford and Keydata's Sales Director] *that they are"*. Mr Johnson was aware that there was considerable doubt about whether SLS would make income payments and that SLS was facing liquidity problems, and that the Lifemark Portfolio faced very significant and unresolved risks to achieving the performance that investors had been led to expect. In responding as he did, he deliberately misled the Authority.

4.73. On 18 January 2009 Mr Johnson informed Mr Ford and Keydata's Sales Director by email that at an upcoming meeting with the Authority to establish the current performance of the Products he intended to confirm that the "[c]*urrent financial position of Lifemark is good*" and the "[c]*urrent financial position of the bonds is good – all income paid and up to date*", and added "*I do not propose talking about the* [2008 Actuarial Review] *at this stage*". At the meeting, which took place on 23 January 2009, Mr Johnson did not inform the Authority of the problems with the Products of which he was aware. Mr Johnson was therefore aware that the Authority continued to be concerned about the performance of the Products and misled the Authority in this regard by withholding relevant information.

4.74. On 5 June 2009, by an email from Keydata's solicitors (which was copied to Mr Johnson), in response to a direct question from the Authority as to when Keydata would receive the next income payments for the SLS Bonds which underpinned the SLS Products, Keydata sent the Authority a spreadsheet setting out forthcoming payments dates in 2009 and 2010 on which Keydata *"will receive income for distribution"* from SLS. The spreadsheet clearly represented that future income was expected from SLS. At the time this spreadsheet was sent, however, Mr Johnson knew that SLS had failed to pay income when it became due in 2007 and 2008 and that there was considerable doubt about whether such payments would be made in future. Therefore, Mr Johnson would have known that the information provided to the Authority was likely to mislead the Authority but failed to correct that information.

## 5. FAILINGS

5.1. The statutory and regulatory provisions relevant to this Final Notice are referred to in Annex A.

**Statement of Principle 1**

5.2. The Authority considers that Mr Johnson failed to act with integrity in carrying out his controlled functions at Keydata in breach of Statement of Principle 1.

5.3. Mr Johnson received professional advice on 5 December 2005 (in relation to the SLS Products) and on 7 February 2008 and 19 June 2008 (in relation to the Lifemark Products) that Keydata's financial promotions contained unclear, incorrect and misleading statements (and as such were not clear, fair and not misleading). He received professional advice on 3 March 2008 that Keydata's due diligence in relation to the Lifemark Products was inadequate. He received professional advice or other information on 23 May 2007, 12 March 2008, 16 April 2008, 19 June 2008 and 3 November 2008 that identified risks to the ability of the Lifemark Products to perform in the manner that investors had been led to expect by Keydata's financial promotions.

5.4. Mr Johnson was aware that the issues with the financial promotions and due diligence set out in paragraph 5.3 had not been addressed, and that the risks set out in that paragraph of the Lifemark Portfolio not performing were not being effectively managed and that investors and IFAs were not aware of these risks. Mr Johnson's awareness of the significance of these issues increased from the launch of

the Lifemark Products on 19 December 2005 onwards, during which time he also became increasingly aware that the SLS Products were not performing and that there was a risk that they might fail. Despite this increasing awareness, he recklessly failed either to take adequate steps to ensure that Keydata addressed the issues and risks that had been identified in relation to the Lifemark Products or to take adequate steps to stop Keydata from marketing and selling the Lifemark Products until effective remedial steps were taken.

5.5. Despite becoming increasingly aware of the severe risks affecting the Lifemark Portfolio, Mr Johnson recklessly failed to take adequate steps to ensure that Keydata took steps to explain or mitigate the risk to existing and potential investors in the Lifemark Products, and that material circulated to such investors gave an accurate impression of the risks to the performance of the Lifemark Portfolio. For example, he failed to ensure that the Lifemark Investment Manager's update on the Lifemark Portfolio, which was approved by Keydata and circulated to IFAs on or around 25 July 2008, gave an accurate impression of the risks to the performance of the Lifemark Portfolio.

5.6. Mr Johnson deliberately misled the Authority by representing to it in a compelled interview on 11 June 2008 that there had never been a problem with the income payments on the SLS Products, and in a compelled interview on 18 November 2008 that the Products (SLS and Lifemark) were on target to meet their obligations, despite being aware that there had previously been problems with the income payments on the SLS Products, that there was considerable doubt about whether SLS would make income payments and of the serious liquidity and other risks with the Lifemark Portfolio.

**Statement of Principle 4**

5.7. The Authority considers that Mr Johnson failed to deal with the Authority in an open and cooperative way and failed to disclose appropriately information of which the Authority would reasonably expect notice in breach of Statement of Principle 4.

5.8. The Authority has reached this conclusion having regard to the matter set out at paragraph 5.6 above, and to the following matters.

5.9. On 23 January 2009, at a meeting with the Authority, Mr Johnson withheld from the Authority the problems with the performance of the Products of which he was aware.

5.10. On 5 June 2009 Keydata (through an email from its solicitors which was copied to

Mr Johnson) provided the Authority with a detailed spreadsheet which represented that Keydata was anticipating receipt of payments throughout 2009 and 2010 from SLS (income under the SLS Bonds) which would fund income payments for the SLS Products. The spreadsheet clearly represented that future income was expected from SLS. However at this time Mr Johnson was aware that SLS had not paid income in 2007 and 2008 and that there was considerable doubt about whether SLS would do so in future. Therefore, Mr Johnson would have known that the information provided to the Authority was likely to mislead the Authority, but failed to correct that information.

5.11. Mr Johnson failed to notify the Authority at any stage: that the SLS Products were not performing and that there was a risk of failure of the SLS Portfolio; of the failure of Keydata to address its professional advisers' concerns over the due diligence for the Lifemark Products and the financial promotions for the Products; or of the risk that the Lifemark Portfolio might not perform as investors expected.

**Fit and Proper**

5.12. By reason of the facts and matters set out above, the Authority considers that Mr Johnson is not fit and proper, because he lacks integrity and has failed to demonstrate a readiness and willingness to comply with the requirements and standards of the regulatory system.

5.13. Mr Johnson's behaviour in many instances was reckless and in one case was deliberate, and his actions were material and as such contributed to the extensive consumer detriment which has arisen from the sale of the Products.

5.14. Mr Johnson's lack of integrity is further demonstrated by his reckless failure to take adequate steps to prevent Keydata from continuing to market and sell the Lifemark Products as fulfilling the conditions set out in the ISA Regulations after becoming aware by 23 December 2008 that it was highly likely that they did not do so.

## 6. SANCTION

**Financial penalty**

6.1. In light of the seriousness of the matters set out in this Final Notice, Mr Johnson's misconduct warrants the imposition of a significant penalty. Mr Johnson provided verifiable evidence of serious financial hardship. Had it not been for his reduced financial circumstances, the Authority would have imposed a financial penalty of

£200,000. In the circumstances the Authority considers it appropriate to publish a statement of misconduct.

6.2. The Authority's policy on the imposition of financial penalties is set out in Chapter 6 of DEPP, which came into force on 28 August 2007.

6.3. In determining whether a financial penalty is appropriate, and the appropriate level of any financial penalty, the Authority is required to consider all the relevant circumstances of a case. Applying the criteria set out in DEPP 6.2, the Authority considers that a financial penalty would be an appropriate sanction in this case, in particular given the serious nature of Mr Johnson's breaches, the risk of loss to which UK consumers were exposed as a result of his breaches and the actual loss which they have suffered.

6.4. DEPP 6.5 sets out a non-exhaustive list of factors that may be of relevance in determining the appropriate level of financial penalty to be imposed on a person under the Act. The Authority considers that the following factors are particularly relevant in this case in assessing what the appropriate financial penalty would be.

**Deterrence**

6.5. The Authority has had regard to the need to promote high standards of regulatory conduct by deterring those who have committed breaches from committing further breaches and by helping to deter others from committing similar breaches.

**If the person has made a profit or avoided a loss as a result of the breach**

6.6. The Authority has had regard to Mr Johnson's earnings from Keydata over the Relevant Period, which amounted to over £673,000.

**The nature, seriousness and impact of the breach**

6.7. The Authority has had regard to the seriousness of Mr Johnson's breaches, including the nature and number of the breaches, the number of investors who were exposed to risk of loss as a result of the breaches, and the significant amount of investor loss actually caused. The Authority has also had regard to the fact that Mr Johnson was not a director of Keydata and in general could not control its actions or failures to act, he was deliberately not informed by the directors of Keydata of some relevant matters concerning the performance of the Products and he was carrying out other significant compliance functions not concerning the Products in respect of which the

Authority has not identified any concerns. Taking all these matters into account the Authority considers that Mr Johnson's breaches are of a serious nature.

**The extent to which the breach was deliberate or reckless**

6.8. In many of the instances set out above Mr Johnson recklessly contravened regulatory requirements or failed to take adequate steps to prevent Keydata from doing so, and he deliberately misled the Authority in respect of the performance of the Products on two occasions.

**Difficulty of detecting the breach**

6.9. The Authority may impose a higher penalty where it considers that a person committed a breach in such a way as to avoid or reduce the risk that the breach would be discovered. Mr Johnson's deliberate misleading of the Authority meant that his (and Keydata's) breaches were harder to detect.

**Conduct following the breach**

6.10. The Authority has taken into account the fact that Mr Johnson failed to make the Authority aware of his (and Keydata's) breaches.

**Disciplinary record and compliance history**

6.11. Mr Johnson has not previously been the subject of disciplinary action by the Authority.

**Other action taken by the Authority**

6.12. The Authority has taken into account action taken by the Authority in respect of other approved or authorised persons for similar behaviour.

6.13. In light of these factors, but especially the seriousness of the misconduct, the risk of loss to which UK consumers were exposed and the actual loss which they have suffered, the Authority considers that the imposition of a financial penalty of £200,000 on Mr Johnson would be appropriate.

**Serious financial hardship – public censure**

6.14. Mr Johnson has provided verifiable evidence that any financial penalty would cause him serious financial hardship. The Authority considers it appropriate to take Mr Johnson's financial position into account and therefore considers that there should be no financial penalty and that, in these circumstances, it is appropriate to publish a statement of Mr Johnson's misconduct. Had it not been for his reduced financial circumstances, the Authority would have imposed a financial penalty of £200,000.

**Prohibition**

6.15. Mr Johnson's misconduct demonstrates that he is not fit and proper. As a result the Authority, having regard to its statutory objectives, including protecting and enhancing the integrity of the UK financial system, and securing an appropriate degree of protection for consumers, prohibits him from performing any function in relation to any regulated activity carried on by an authorised person, exempt person or exempt professional firm.

## 7. PROCEDURAL MATTERS

**Decision Maker**

7.1. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

**Publicity**

7.3. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notices relates. Under those provisions, the Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

7.4. The Authority intends to publish such information about the matter to which this

Final Notice relates as it considers appropriate.

**Authority contacts**

7.5. For more information concerning this matter generally, contact Kevin Thorpe (direct line: 020 7066 4450) of the Enforcement and Market Oversight Division of the Authority.

**Anthony Monaghan**
**Project Sponsor**
**Financial Conduct Authority, Enforcement and Market Oversight Division**

## ANNEX A

## RELEVANT STATUTORY AND REGULATORY PROVISIONS

### 1. RELEVANT STATUTORY PROVISIONS

1.1. The Authority's statutory objectives, set out in section 1B(3) of the Act, include protecting and enhancing the integrity of the UK financial system, and securing an appropriate degree of protection for consumers.

1.2. The Authority has the power pursuant to section 56 of the Act to make an order prohibiting an individual from performing a specified function, any function falling within a specified description, or any function, if it appears to the Authority that that individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person, exempt person or exempt professional firm. Such an order may relate to a specified regulated activity, any regulated activity falling within a specified description, or all regulated activities.

1.3. Section 66 of the Act provides:

"*(1)* [The Authority] *may take action against a person under this section if –*

*(a) it appears to the* [Authority] *that he is guilty of misconduct; and*

*(b) the* [Authority] *is satisfied that it is appropriate in all the circumstances to take action against him.*

*(2) …a person is guilty of misconduct if, while an approved person –*

*(a) the person has failed to comply with a statement of principle issued by the* [Authority] *under section 64…*

*(3) If the* [Authority] *is entitled to take action under this section against a person, it may…*

*(a) impose a penalty on him of such amount as it considers appropriate;*

…

*(b) publish a statement of his misconduct.*

*(4)* [The Authority] *may not take action under this section after the end of the period of three years beginning with the first day on which the* [Authority] *knew of the misconduct, unless proceedings in respect of it against the person concerned were begun before the end of that period.*

*(5) For the purposes of subsection (4) –*

*(a)* [the Authority] *is to be treated as knowing of misconduct if it has information from which the misconduct can reasonably be inferred; and*

*(b) proceedings against a person in respect of misconduct are to be treated as begun when a warning notice is given to him under section 67(1)."*

1.4. The three-year period in section 66(4) took effect from 8 June 2010, following an amendment made to that section by section 12(1) of the Financial Services Act 2010. Prior to that amendment, the period provided for in section 66(4) was two years.

1.5. Throughout the Relevant Period, the ISA Regulations provided as follows:

***"7.— Qualifying investments for a stocks and shares component***

*(1) This regulation specifies the kind of investments ("qualifying investments for a stocks and shares component") which may be purchased, made or held under a stocks and shares component…*

*(2) Qualifying investments for a stocks and shares component to which paragraph (1) refers are–*

*…*

*(b) securities ("qualifying securities") –*

*(i) issued by the company wherever incorporated…*

*(ii) which satisfy at least one of the conditions specified in paragraph (5) and the condition specified in paragraph (6)…*

*…*

*(5) The conditions specified in this paragraph are–*

*(a) that the shares in the company issuing the securities are listed on the official list of a recognised stock exchange;*

*(b) that the securities are so listed;*

*(c) that the company issuing the securities is a 75 per cent. subsidiary of a company whose shares are so listed.*

*(6) The condition specified in this paragraph is that, judged at the date when each of the securities is first held under the account, the terms on which it was issued do not –*

*(a) require the loan to be repaid or the security to be re-purchased or redeemed, or*

*(b) allow the holder to require the loan to be repaid or the security to be repurchased or redeemed except in circumstances which are neither certain nor likely to occur,*

*within the period of five years from that date."*

## 2. RELEVANT REGULATORY PROVISIONS

2.1. The Statements of Principle are issued under section 64 of the Act.

2.2. During the Relevant Period, Statement of Principle 1 stated:

"*An approved person must act with integrity in carrying out his controlled function.*"

2.3. During the Relevant Period, Statement of Principle 4 stated:

"*An approved person must deal with the* [Authority]… *and other regulators in an open and cooperative way and must disclose appropriately any information of which the* [Authority] *would reasonably expect notice.*"

2.4. One of the purposes of FIT is to set out and describe the criteria that are relevant in assessing the continuing fitness and propriety of approved persons.

2.5. FIT 1.1.1G provides that it applies to an approved person.

2.6. FIT 1.3.1G sets out that the Authority will have regard to a number of factors when assessing the fitness and propriety of a person to perform a particular controlled function. One of the most important considerations will be the person's honesty, integrity and reputation.

2.7. FIT 2.1.1G sets out that in determining a person's honesty, integrity and reputation the Authority will have regard to all relevant matters including, but not limited to, those set out in FIT 2.1.3G. FIT 2.1.3G(13) includes, as one of the relevant matters the Authority will consider, whether the person demonstrates a readiness and willingness to comply with the requirements and standards of the regulatory system and with other legal, regulatory and professional requirements and standards.

2.8. The Authority's general approach to determining whether to impose a financial penalty or public censure and the appropriate level of any such penalty is set out in DEPP. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have breached regulatory requirements from committing further contraventions, helping to deter others from committing similar breaches and demonstrating generally the benefits of compliant behaviour (DEPP 6.1.2G). DEPP 6.2 sets out a non-exhaustive list of factors that may be relevant to determining whether to impose a financial penalty. DEPP 6.4 lists a number of factors that may be relevant to deciding whether it is appropriate to issue a public censure rather than a financial penalty. This includes "*where the application of the* [Authority]*'s policy on serious financial hardship (set out in DEPP 6.5D) results in a financial penalty being reduced to zero*" (DEPP 6.4.2G(8)(a)). DEPP 6.5.2G sets out a non-exhaustive list of factors that may be relevant to determining the appropriate level of financial penalty.

2.9. In considering whether to impose a financial penalty and the amount of the penalty to impose, the Authority has also had regard to the provisions of ENF and EG which were in force during the Relevant Period.

2.10. Guidance relating to prohibition orders is contained in EG at EG 9. This states that the Authority may exercise its power to prohibit individuals where it considers that, to achieve any of its statutory objectives, it is appropriate to prevent an individual from performing any function in relation to regulated activities (EG 9.1).

2.11. EG 9.8 provides:

"*When the* [Authority] *has concerns about the fitness and propriety of an approved person, it may consider whether it should prohibit that person from performing functions in relation to regulated activities, withdraw its approval, or both. In deciding whether to withdraw its approval and/or make a prohibition order, the* [Authority] *will consider in each case whether its statutory objectives can be achieved adequately by imposing disciplinary sanctions, for example, public censures or financial penalties, or by issuing a private warning*".

2.12. EG 9.3 provides:

"*In deciding whether to make a prohibition order… the* [Authority] *will consider all the relevant circumstances including whether other enforcement action should be taken*".

2.13. When deciding whether to make a prohibition order, the Authority will consider all relevant circumstances of the case which may include but are not limited to the following criteria set out in EG 9.9:

*"(2) Whether the individual is fit and proper to perform functions in relation to regulated activities.* [The criteria for assessing this are set out in FIT.]

*(3) Whether and to what extent the approved person has:*

*(a) failed to comply with the Statements of Principle issued by the* [Authority] *with respect to the conduct of approved persons;*

*…*

*(5) The relevance and materiality of any matters indicating unfitness.*

*(6) The length of time since the occurrence of any matters indicating unfitness.*

*(7) The particular controlled functions the approved person is (or was) performing, the nature and activities of the firm concerned and the markets in which he operates.*

*(8) The severity of the risk which the individual poses to consumers and to confidence in the financial system."*

2.14. EG 9.5 provides:

"*The scope of a prohibition order will depend on the range of functions which the individual concerned performs in relation to regulated activities, the reasons why he is not fit and proper and the severity of risk which he poses to consumers of the market generally.*"

2.15. EG 9.10 provides:

"*The* [Authority] *may have regard to the cumulative effect of a number of factors which, when considered in isolation, may not be sufficient to show that the individual is fit and proper to continue to perform a controlled function or other function in relation to regulated activities. It may also take account of the particular controlled function which an approved person is performing for a firm, the nature and activities of the firm concerned and the markets within which it operates.*"

2.16. EG 9.12 provides a non-exhaustive list of examples of behaviours which have previously resulted in a prohibition order:

"*(1) Providing false or misleading information to the* [Authority*]; including information relating to identity, ability to work in the United Kingdom, and business arrangements;*

*…*

*(3) Severe acts of dishonesty, e.g. which may have resulted in financial crime;*

*(4) Serious lack of competence; and*

*(5) Serious breaches of the Statements of Principle for approved persons, such as failing to make terms of business regarding fees clear or actively misleading clients about fees; acting without regard to instructions; providing misleading information to clients, consumers or third parties; giving clients poor or inaccurate advice; using intimidating or threatening behaviour towards clients and former clients; failing to remedy breaches of the general prohibition or to ensure that a firm acted within the scope of its permissions."*